IT 97-2
Tax Type: INCOME TAX
Issue: Penalty Under 1002(d) – Failure To File/Pay Withholding

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	)	
v.	)	**No.**
	)	**SSN:**
TAXPAYER,	)	
Taxpayer	)	**C. O'Donoghue** **Admin. Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: TAXPAYER *pro se*; Mr. Thomas P. Jacobsen, Special Assistant Attorney General, for the Illinois Department of Revenue.

Synopsis:

This matter comes on for hearing pursuant to the taxpayer's timely protest of Notice of Deficiency No. XXX issued by the Department on March 17, 1989 for withholding tax liability. Such Notice of Deficiency was issued to TAXPAYER (hereinafter "TAXPAYER" or the "taxpayer") as a responsible officer of CORPORATION ("CORPORATION") pursuant to Section 1002(d) of the Illinois Income Tax Act.

The issues to be resolved are 1) whether the taxpayer was a responsible officer of CORPORATION and thereby required to collect, truthfully account for and pay over the withholding tax and 2) whether the taxpayer willfully failed to collect, truthfully account for and pay over such taxes for the fourth quarter

of 1985, the first quarter of 1986 and the fourth quarter of 1987 (hereinafter "tax period").

A hearing was held on December 3, 1996. Upon consideration of all the evidence, it is recommended that this matter be resolved in favor of the Department.

Findings of Fact:

1. The Department's *prima facie* case was established by the admission into evidence of the Notice of Deficiency, dated March 17, 1989, showing a total liability due and owing in the amount of $10,299.43 for the tax period. Dept. Ex. No. 1.

2. CORPORATION had filed for bankruptcy under Chapter 11 of the Bankruptcy Code. Tr. p. 70. The bankruptcy stay was lifted on March 2, 1994.

3. TAXPAYER was the incorporator and as the corporation's attorney prepared the Articles of Incorporation on behalf of the shareholders in 1982. Tr. pp. 64, 80. He subscribed to half of the initial issue of shares. Tr. p. 80; Dept. Ex. No. 9. Taxpayer is an attorney with a full-time practice in XXXXX, Illinois. Tr. p. 18.

4. TAXPAYER was a shareholder as well as a director throughout the relevant period. Tr. p. 65. His interest in the company varied from one-third to approximately 25 percent due to new investors. Tr. p. 65.

5. TAXPAYER was also the secretary/treasurer of the company during the tax period. Tr. p. 71. He became president of the corporation in 1987, after FORMER PRESIDENT's, the president, departure. Tr. p. 65. Taxpayer drew a salary of $15,000 a year. Tr. pp. 67, 68.

6. Taxpayer's wife, TAXPAYER’S WIFE jointly owned the shares of stock with the taxpayer and for 1986 was a vice-president and a director of the corporation. Tr. p. 81.

7. During 1984 through 1987, BOOKKEEPER was employed as the bookkeeper and office manager. Tr. p. 42. BOOKKEEPER handled the payroll responsibilities, including calculating the employees' work hours and the miles the owner/operators had traveled. She then prepared the checks. Tr. p. 42. BOOKKEEPER also kept track of incoming bills and prepared the payment checks. Tr. p. 43.

8. CORPORATION had at least three bank accounts, a checking account at BANK used as a depository account, a second account at BANK used for payroll and a checking account in XXXXX (this XXXXX account was later transferred to XXXXX Savings Bank) from which the corporate bills were paid. Dept. Ex. No. 14, 15. TAXPAYER was a signatory on CORPORATION's bank accounts. Dept. Ex. No. 5A, 14.

9. BOOKKEEPER would deposit customer receipts in the depository account at BANK and would then call TAXPAYER, almost daily, to inform him of the amount deposited. BOOKKEEPER did not keep track of this account's balance nor did she receive any reports or bank statements concerning this depository account. Tr. pp. 45-49. Taxpayer wrote a check to transfer funds from the BANK depository account to the XXXXX bank account and would inform BOOKKEEPER as to what funds were available for the payment of bills. BOOKKEEPER did not keep track of the amount transferred nor did she have access to checks for the depository account at BANK. Tr. pp. 45-47. This office procedure continued throughout her employment, from 1984 to 1987. Tr. p. 47. Mrs. BOOKKEEPER received permission from TAXPAYER before she paid the bills due to the almost daily transfer of funds and because the taxpayer depleted the funds by paying equipment bills at his office. Thus, the taxpayer was the only one aware of the XXXXX checking account's balance to pay the bills. Tr. pp. 43, 44, 50, 56, 57. BOOKKEEPER would discuss what bills she had with the taxpayer, XXXXX, XXXXX or FORMER PRESIDENT. Tr. p. 44.

10. TAXPAYER along with XXXXX and FORMER PRESIDENT shared the responsibility for the operations of CORPORATION. Tr. p. 20.

11. FORMER PRESIDENT, as president of the company, handled many of the daily affairs of CORPORATION which included paying the bills and the corporate employees. Tr. pp. 23, 24.

12. TAXPAYER had the power to hire and fire personnel for CORPORATION. He, in fact, hired and later fired both FORMER PRESIDENT and Mrs. BOOKKEEPER. Tr. pp. 32, 33, 55.

13. Taxpayer borrowed $82,500 from the Bank of XXXXX and subsequently lent this money to CORPORATION for equipment purchases. Tr. pp. 91, 92; Dept. Ex. No. 15.

14. Subsequent to the Chapter 11 Bankruptcy filing, the taxpayer became even more involved in the company's activities, (Tr. p. 135), and exerted a great deal of control over operations. Tr. pp. 136, 137. Taxpayer was responsible for filing a debtor in possession report every month with the bankruptcy court. Tr. p. 71.

15. The taxpayer had authority to purchase equipment on behalf of CORPORATION. Tr. pp. 96, 97, 130, 137; Dept. Ex. No. 18, 19, 20. He also purchased equipment on behalf of himself and leased it back to CORPORATION. Dept. Ex. No. 18, 24. Taxpayer was a guarantor or an owner on approximately 10 or 12 of the company's trailers and a guarantor or an owner on about six tractors. Tr. pp. 138, 139. TAXPAYER also guaranteed loans for CORPORATION. Dept. Ex. No. 7, 8.

16. At one annual meeting the taxpayer was authorized to secure a 26 million dollar loan for the company. Tr. p. 102; Dept. Ex. No. 21.

17. TAXPAYER signed checks on behalf of CORPORATION to himself and his partners in XXXXX partnership which was formed to buy equipment and lease it to CORPORATION. Some checks reflect payments to creditors who had a security interest in TAXPAYER's property. Tr. pp. 116-119, 140; Dept. Grp. Ex. No. 23.

18. TAXPAYER knew of CORPORATION's past tax delinquencies with the Federal government. Dept. Ex. No. 5 p. 33; Tr. pp. 8-10, 51, 52.

Conclusions of Law:

The Department seeks to impose personal liability on TAXPAYER pursuant to Section 1002(d) of the Illinois Income Tax Act which provides:

> Any person required to collect, truthfully account for, and pay over the tax imposed by this Act who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the amount of the tax evaded, or not collected, or not accounted for and paid over ... .

Ill. Rev. Stat. 1991, ch. 120, 10-1002(d).[1]

Section 1002(d) is modeled after Section 6672 of the Internal Revenue Code, which imposes liability upon those individual persons actually responsible for an employer's failure to withhold and pay over the taxes. Allen v. United States, 547 F. Supp. 357 (N.D. Ill. 1982).

In determining whether an individual is a responsible person the courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and disbursal of funds. *See, e.g.*, Monday v. United States, 421 F.2d 1210 (7th Cir. 1970), cert. denied 400 U.S. 821 (1970). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the withholding taxes are remitted to the Government. *Id.* Thus, the statute does not confine liability to the single most responsible person. Howard v. United States, 711 F.2d 729 (5th Cir. 1983).

Although title alone is insufficient to constitute a finding of responsibility, it is clear from both testimony and documentary evidence that TAXPAYER had significant control over the corporation and its employees.

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[1]. The Uniform Penalty and Interest Act, 35 **ILCS** 735/3-7, which provides for personal liability penalty, is effective for taxes incurred as of January 1, 1994.

Taxpayer himself concedes that with regard to the fourth quarter of 1987, he had great control over the company and under the statute his position is very weak. He also adds "a ruling against me as to that quarter isn't going to be terribly upsetting." Tr. p. 136. An examination of the record, however, reveals that he was not only a responsible officer for the fourth quarter of 1987 but for the entire tax period as well. During the remaining quarters, it may be that TAXPAYER was never involved in the details of preparing checks for creditors, however, given the control he exerted over corporate funds, he was far more than a passive investor.

TAXPAYER was CORPORATION's incorporator and an original shareholder. During the tax period, he held the positions of secretary, treasurer, director and during the end of 1986, president. Taxpayer asserts he never fulfilled the duties of a secretary/treasurer yet did not produce any documentary evidence to prove his claims. TAXPAYER had the power to hire and fire personnel. He, in fact, hired FORMER PRESIDENT, who was the terminal manager and later the president of the corporation and Mrs. BOOKKEEPER, who directly handled the company's accounts payable.

TAXPAYER was a signatory on all of the corporation's bank accounts. Although TAXPAYER was not aware of each individual check Mrs. BOOKKEEPER wrote, he did exert control over BOOKKEEPER and ultimately the payment of bills by controlling the transfer of funds from bank to bank and being the sole party with knowledge of how much money was available to pay the corporate bills. Mrs. BOOKKEEPER provided credible testimony that she needed permission from the taxpayer before paying the bills and spoke with him regarding these bills almost daily. TAXPAYER's power to prohibit the allocation of corporate funds is the type of control which establishes the taxpayer as a responsible person.

Further, TAXPAYER's ability to borrow significant sums of money on behalf of CORPORATION and to purchase equipment for the corporation is further evidence of a person with significant power and control within the corporation. TAXPAYER

was also a creditor of CORPORATION. He bought equipment and leased it back to the company and personally guaranteed loans for the corporation. TAXPAYER admitted he wrote checks for equipment payments during the tax period. Taxpayer had the power and responsibility within the corporation for ensuring that the taxes were remitted and yet failed to do so, and the mere fact that other officers and employees also had control over financial matters does not exonerate TAXPAYER from liability. *See*, Gephart v. Unites States, 818 F.2d 469 (6th Cir. 1987).

Based on the foregoing, I believe sufficient evidence was presented to establish that TAXPAYER wielded significant control over the corporate finances and therefore, was a responsible person as required under the statute.

It must also be determined whether TAXPAYER willfully failed to remit the withholding taxes to the Department. Willfulness in regards to Section 1002(d) is not merely limited to "intentional, knowing and voluntary acts". Monday, 421 F.2d at 1215. Willful as applied in Section 6672, and hence 1002(d), encompasses a reckless disregard for obvious or known risks.[1] *Id*.

In Branson v. Department of Revenue, 168 Ill.2d 247 (1995), the Illinois Supreme Court held that the introduction of the Notice of Penalty Liability was sufficient to establish a *prima facie* case of willful failure to pay retailers' occupation taxes. The court was addressing the Retailers' Occupation Tax Act, however, the holding in Branson should apply equally in this case because not only are the underlying policies of the ROT section and section 1002(d) similar but the language of the two sections encompasses both responsibility and willfulness.

In the present case, however, there is evidence showing TAXPAYER acted willfully. In 1985, taxpayer knew CORPORATION was having serious financial difficulties, and nonetheless, personally wrote checks on behalf of CORPORATION

[1]. The Illinois Supreme Court in Department of Revenue v. Heartland Investments, 106 Ill.2d 19, 29 (1985), accepted that cases arising under section 6672 of the IRC provided guidance in determining the meaning of the "willful failure" requirement of Chapter 120 par. 452 1/2 (13 1/2).

to his business and law partners for equipment they had leased to the company. Payments were also made to himself and to creditors who had a security interest in TAXPAYER's equipment. TAXPAYER felt he needed to "protect those people who had trusted me enough to purchase equipment to lease to CORPORATION." Tr. pp. 117-119. Both BOOKKEEPER and Rieck provided credible testimony that TAXPAYER knew of past tax delinquencies with the Federal government. Given the fact that the company had past federal tax problems and the taxpayer's knowledge of the current financial difficulties, his position in the company required that he investigate whether or not the corporation had not once again fallen behind on its payment of taxes. TAXPAYER could have easily confirmed payment since as a secretary/treasurer/director of the corporation he had access to the company's books and records and had almost daily contact with the corporate office. The fact that TAXPAYER had adopted a "hear no evil - see no evil" policy does not relieve him of liability. Wright v. United States, 809 F. 2d 425 (7th Cir. 1987), accord, Calderone v. United States, 799 F. 2d 254, 260 (6th Cir. 1986), *quoting* Bolding v. United States, 565 F.2d 663, 674 (1977) ("Thus, it cannot be that 'a responsible officer may immunize himself from the consequences of his actions by wearing blinders which will shut out all knowledge of the liability for the nonpayment of [the corporation's] withholding taxes.'"). Nor does the record reflect any attempts by the taxpayer to institute effective financial controls to guard against nonpayment. In light of the corporation's history of noncompliance, such steps should have been taken. *See*, Wright, *supra*.

Furthermore, the taxpayer has failed to submit sufficient evidence of his lack of willfulness to rebut the Department's *prima facie* case. "In order to overcome the presumption of validity attached to the Department's corrected returns" the taxpayer "must produce competent evidence, identified with their books and records." Copilevitz v. Department of Revenue, 41 Ill.2d 154 (1968); Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978). Oral testimony is not sufficient to overcome the prima facie correctness of the

Department's determinations. A.R. Barnes v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988).

WHEREFORE, for the reasons stated above, it is my recommendation the Notice of Deficiency be finalized as issued.

Christine O'Donoghue
Administrative Law Judge